IN THE

Supreme Court of the United States

OCTOBER TERM, 1943

No. [illegible]

PENNSYLVANIA POWER & LIGHT COMPANY,
Petitioner,

v.

FEDERAL POWER COMMISSION,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF IN SUPPORT THEREOF

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To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your petitioner, Pennsylvania Power & Light Company, respectfully prays that a writ of certiorari be issued to review the decree of the United States Circuit Court of Appeals for the Third Circuit entered in the above cause on December 7, 1943 (R. 607), pursuant to decision of that Court rendered on the same date, affirming orders of the Federal Power Commission dated April 14, 1942 and June 10, 1942, determining the actual legitimate original cost of Petitioner's Wallenpaupack power project.

Statutes Involved

The statutes involved are the Federal Water Power Act of 1920 (41 Stat. 1063-1077) and the Federal Power Act of 1935 (49 Stat. 838-863; 16 U. S. C. A. §§ 791a-825r). Primary concern is with Section 4(a) of the former Act (41 Stat. 1065) as originally enacted and as amended by Section 202 of the latter Act (49 Stat. 839; 16 U. S. C. A. § 797(b)) dealing with determination of net investment in a license project, and with the definition of "net investment" contained in Section 3 of the former Act (41 Stat. 1064) and continued in the latter Act (49 Stat. 838; 16 U. S. C. A. § 796(13)). Other provisions involved are Section 14 of the Federal Water Power Act as originally enacted (41 Stat. 1071) and as amended by the Federal Power Act (49 Stat. 844; 16 U. S. C. A. § 807); Section 28 of the Federal Water Power Act (41 Stat. 1077); and Sections 201(a) and 301(a) of the Federal Power Act (49 Stat. 847; 16 U. S. C. A. § 824, and 49 Stat. 854; 16 U. S. C. A. § 825, respectively).

Opinions Below

The opinions of the Federal Power Commission were filed April 14, 1942 (Appendix, 483a-527a) and June 10, 1942; the latter opinion denied rehearing with respect to issues here involved (Appendix, 541a, 542a)*.

The opinion of the Circuit Court of Appeals (R. 592-607) is reported in 139 F. (2d) 445.

* The Appendix to Petitioner's Brief in the Circuit Court of Appeals has been certified to this Court and constitutes the printed record on which the case was heard in the Court below. Hereafter this Appendix will be cited merely by page references followed by the letter "a," and all such references are to the Appendix, unless the Record in the Court of Appeals, designated "R" followed by page number, is indicated.

Jurisdiction

The decree of the Circuit Court of Appeals sought to be reviewed was entered December 7, 1943 (R. 607). Rehearing was denied on February 11, 1944 (R. 621). The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended (28 U. S. C. A. § 347a).

Questions Presented

(1) May the Federal Power Commission in determining the "actual legitimate original cost" of a licensed power project, as those terms are defined in Section 3 of the Federal Water Power Act of 1920 (41 Stat. 1064), adopt retroactively as to a project constructed during the years 1924 to 1926, the so-called "no profit to affiliates" rule embodied for the first time as a matter of Federal statutory policy in the Public Utility Act of 1935 (Title I, Section 13(b), 49 Stat. 825, 15 U. S. C. A. § 79m(b)), of which the Federal Power Act of 1935 is Title II?

(2) Where the Federal Water Power Act of 1920 provides that "net investment" in a project means the actual legitimate original cost thereof as defined and interpreted in the "classification of investment in road and equipment of steam roads, issue of 1914, Interstate Commerce Commission," and this provision is reenacted in identical language in the Federal Power Act of 1935, may the Federal Power Commission disregard interpretations by the Interstate Commerce Commission allowing charges paid to affiliates as proper costs, such interpretations being made after the passage of the 1920 Act but before the Act of 1935?

(3) May the Commission also disregard the settled law established by prevailing judicial decisions at the time the project was constructed in favor of its new and different conception of public policy, as expressed in its "no profit to affiliates" rule?

(4) Even if the items disallowed were properly removed from the project costs under the rule adopted by the Commission, may they be ordered removed from all asset accounts by charge to earned surplus, as those accounts appear in Petitioner's fundamental corporate books kept subject to State laws and the requirements of State authorities?

Statement

The decision below was rendered upon a petition filed under Section 313(b) of the Federal Power Act of 1935 (49 Stat. 860, 16 U. S. C. A. § 825-1(b)), by Pennsylvania Power & Light Company for review of orders of the Federal Power Commission determining the actual legitimate original cost of Petitioner's Wallenpaupack power project.

The Wallenpaupack Project was constructed by Petitioner during the years 1924 to 1926 under license dated September 29, 1924, issued by the Commission in the usual form for such licenses for projects on navigable streams under the Federal Water Power Act of 1920 (41 Stat. 1063; 16 U. S. C. A. §§ 791, *et seq.*) for a term of fifty years. Pursuant to the requirements of the Act and of the license, Petitioner filed with the Commission in due course, its statement of actual legitimate original cost which, as supplemented by annual statements of additions, et cetera, to December 31, 1934, claimed a total cost of $9,148,755.88. After investigations of this statement and hearings thereon, the Commission issued its Opinion No. 68 and Order dated April 14, 1942, in which it found the actual legitimate original cost to December 31, 1934 to be $8,573,895.70, and directed that $540,574.74* of the amount

* By Order dated September 29, 1942, after rehearing this charge was reduced to $500,721.12 (563a) but not affecting the items involved in this petition.

disallowed be removed not only from the project accounts, but from every asset account of the Petitioner, and charged to earned surplus (483a-527a).

Included among the items disallowed and ordered charged to surplus were charges of Petitioner's controlling affiliate or parent company, Electric Bond and Share Company (Bond and Share), consisting of a construction fee of $197,596.35 paid to Bond and Share's construction subsidiary Phoenix Utility Company (Phoenix), and $93,629.87 of the engineering charges made by the engineering department of Bond and Share.*

The entire Phoenix fee was disallowed solely because it represented compensation in excess of the identifiable overhead cost to Phoenix or Bond and Share, and therefore constituted a "profit" (489a-496a) and $84,555.75 of the engineering charges were disallowed for the same reason, the profit, however, being computed by a redetermination by the Commission's staff, adopted by the Commission, of the overhead charges allocated to engineering by Bond and Share (497a-509a).

The Phoenix fee was based upon a construction contract which in effect provided for a fee of 3% on the contractual base cost (116a, 568a), and the engineering fee was based on an engineering contract supplemented by work orders which provided for the payment of salary cost of engineers and department employees assigned to the work, plus a conventional overhead which, although stated somewhat differently in the different work orders, aver-

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* This petition for certiorari presents directly only the questions of disallowance and accounting disposition of the Phoenix construction fee and the Bond and Share engineering overhead charge. If the Commission and court action should be reversed on account of these disallowances, recalculation of interest during construction would necessarily follow as a matter of mechanics. The remaining disallowances, while we disagree with them, we do not believe justify resort to this Court.

aged about 95% of the base salary cost (374a-375a). Bond and Share in its books of account (184a-206a), Haskins & Sells, its auditors (206a-226a), and the Federal Trade Commission in its utility investigation (227a-231a), supported the overhead charge, but the Commission made an independent recalculation of overhead of 50% of salaries, and disallowed the balance as profit (308a-408a, Opinion, 497a-509a).

To state the facts in detail would unduly prolong this petition. It is sufficient to say here that every element involved in proof of the necessity for and reasonableness of the charges was fully shown (54a-65a, 148a-182a). Petitioner had no experienced staff, or equipment, to do the engineering or construction work; was obliged to go outside of its own organization for the work and selected Bond and Share for the purpose, though not compelled so to do (54a-65a, 96a-97a, 102a). The work was entirely done by Bond and Share and its subsidiary construction company without aid or assistance of Petitioner (100a-116a, 143a-144a). The work was well done, economically done, and the charges made were reasonable both as related to cost and as to charges which would be made by non-affiliated companies (148a-182a, 480a-482a). The Commission in its opinion stated, in substance, that the issue is not one of reasonableness, but of control, and control existing, no profit is allowable (489a-490a, 497a).

On May 13, 1942, Petitioner filed with the Commission its Application for Rehearing, setting forth, *inter alia*, that the Commission erred in these disallowances and the disposition thereof (528a-540a).

On June 10, 1942, the Commission denied rehearing on the issues here involved (541a-542a). On August 5, 1942, a petition for review of the Commission's action in the matters above stated was filed in the Circuit Court of Ap-

peals for the Third Circuit (543a-559a). That Court in all respects affirmed the decision of the Commission (R. 607).

In order to relate and confine the factual discussion to the legal questions involved, we premise that Section 3 of the Federal Water Power Act of 1920 (41 Stat. 1064) defines "net investment" in a project as "the actual legitimate original cost thereof as defined and interpreted in the 'classification of investment in road and equipment of steam roads, issue of 1914, Interstate Commerce Commission,' plus similar costs of additions thereto and betterments thereof * * *." This definition is continued in the Federal Power Act of 1935, Section 3(13) (49 Stat. 838; 16 U. S. C. A. § 796). Under "General Instructions," page 9, item 1 of this classification, it is stated that the prescribed accounts are designed to show the investment of the "carrier" in property and that the "carrier" means the "accounting carrier," and on page 10, item 2, it is stated that costs shall be the "actual money costs" to the "carrier."

The basic rules governing original cost determination were set forth by the Interstate Commerce Commission in *Texas Midland Railroad*, 75 I. C. C. 1, 176 (1918) in a manner which we believe, and shall argue, is in principle conclusive of the question here involved. At the time of the passage of the Federal Water Power Act of 1920 that case was the guiding authority used and referred to in Congress for the adoption of the statutory definition (Cong. Rec., 65 Cong. 2d Sess., p. 9957). At the time of such passage there had been no express interpretation by the Interstate Commerce Commission applying to the specific problem of contracts between affiliates, the principles outlined in the *Texas Midland* case.

But subsequent to the passage of the Act of 1920, and prior to the passage of the amended Act of 1935, the Interstate Commerce Commission had before it in many cases

the question whether costs paid by a carrier to an affiliated construction or supply company were to be allowed, and uniformly sustained all such payments as original cost to the carrier, without differentiating between them and payments made to non-affiliated contractors. For illustration see *Southern Pacific Co., et al.*, 45 I. C. C. Val. 1, 12 (1933), *Atlantic City & Shore Railroad Co.*, 125 I. C. C. 353, 356, 370, 371 (1927); *cf. Brimstone Railroad & Canal Co.*, 141 I. C. C. 445, 446 (1928); *Mobile & Gulf Railroad Co.*, 43 I. C. C. Val. 309, 314, 316 (1933); *Chaffee Railroad Co.*, 43 I. C. C. Val. 925-927, 935 (1933). For a further application of the I. C. C. ruling made subsequent to 1935, see *Pullman Company*, 47 I. C. C. Val. 501 (1936).

The Court below, however, cites a ruling of the Federal Power Commission in the case of *Louisville Hydro-Electric Company*, 1 F. P. C. 130 (1933) and the Fourteenth Annual Report of the Commission on December 1, 1934, as supporting the "no profit to affiliates" rule, and concludes in effect, that the subsequent reincorporation in the 1935 Act of the 1920 definition of actual legitimate original cost does not incorporate the intervening interpretations of this classification by the Interstate Commerce Commission (Opinion, R. pp. 594-589).

We submit that this ruling of the Court below accords to the Power Commission the authority to erect standards of conduct not only in excess of those authorized by the statute under which it acts, but in direct contravention of those statutory standards.

There can be little doubt that the recognition of the possibility, if not probability, of "evils" in contracts between a controlling company and its controlled affiliate have prompted not only increased judicial scrutiny, but express legislative condemnation of such contracts. The Public Utility Act of 1935 (49 Stat. 803-863), of which the Federal Power Act is Title II, contains as Title I, the Public Utility

Holding Company Act. In Section 13 of this Act (49 Stat. 825; 15 U. S. C. A. § 79m) Congress for the first time expressly prohibited inter-company service and construction contracts at a profit in public utility holding company systems. But that Act, while approved on August 26, 1935, postpones the effective date of this prohibition to April 1, 1936, thus recognizing the widespread existence of such contracts, and the legality, so far as Congress is concerned at least, of their continued performance for a period of some eight months after approval of the Act.

The holding of the Commission in this case sustained by the Court below condemning this "profit" solely because of the fact of affiliation and without regard to other circumstances, gives *retroactive* application to a *prospective* statutory regulation. There can be no question that during the period of the construction of this project (1924-1926) the courts, in a long line of decisions, recognized the legitimacy of these contracts if fair and reasonable, and their validity was dependent not on the intrinsic fact of affiliation but on extrinsic considerations of reasonableness. *Missouri ex rel. Southwestern Bell Telephone Company* v. *Public Service Commission*, 262 U. S. 276 (1923), *Smith* v. *Illinois Bell Telephone Company*, 282 U. S. 133 (1930), *Western Distributing Co.* v. *Public Service Commission of Kansas*, 285 U. S. 119 (1932), and *Dayton Power & Light Co.* v. *Public Utilities Commission of Ohio*, 292 U. S. 290 (1934). These decisions have been uniformly followed by Federal District Courts. A few of the cases are cited in the margin.*

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* *Southwestern Bell Tel. Co.* v. *San Antonio*, 75 F. (2d) 880, 883 (C. C. A. 5, 1935), cert. den. 295 U. S. 754 (1935); *Illinois Bell Tel. Co.* v. *Gilbert*, 3 F. Supp. 595, 602 (N. D. Ill. 1933); *Pacific Tel. & Tel. Co.* v. *Whitcomb*, 12 F. (2d) 279, 284, 285 (W. D. Wash. 1926); *Southern Bell Tel. & Tel. Co.* v. *Railroad Commission*, 5 F. (2d) 77, 86, 97 (E. D. S. C. 1925); *Northwestern Bell Tel. Co.* v. *Spillman*, 6 F. (2d) 663 (D. Neb. 1925); *Indiana Bell Tel. Co.* v. *Public Service Commission*, 300 Fed. 190, 204 (D. Ind. 1924); *Southern Bell Tel. & Tel. Co.* v. *Railroad Commissioners*, 299 Fed. 615 (E. D. S. C. 1923); *Chesapeake & Potomac Tel. Co.* v. *Whitman*, 3 F. (2d) 938, 957 (D. Md. 1925); *New York Tel. Co.* v. *Prendergast*, 36 F. (2d) 54, 63, 67 (S. D. N. Y. 1929).

It is perfectly apparent from a cursory reading of the decision of the Commission (see particularly pp. 489a-499a) and of the Court (R. 597-601) as against the relevant portions of the testimony (61a-182a*) that the decision of both Commission and Court is based upon the social philosophy inherent in the "no profit to affiliates" theory, and not on the record facts which the Commission should have found or at least considered and passed upon in this particular case. In other words, we do not have an administrative finding of relevant facts, but refusal to consider such facts because of the adoption of standards created *ad hoc* by the Commission itself.

The facts of affiliation are nowhere in dispute. Bond and Share, to whom the fees were paid, owned fifteen per cent. of the voting stock of Petitioner's controlling holding company, Lehigh Power Securities Corporation (55a-56a, 490a). Notwithstanding this minority interest in stock it had, through voting trust arrangements, interlocking directorates and servicing arrangements, working control of Petitioner. If such affiliation *per se* destroyed the validity of any profit element in intercompany contracts under existing law at the time these contracts were performed, the decision was correct. If the facts of necessity of the services, efficiency and economy of their performance, and the reasonableness of the charges out of which the profit was generated, are relevant, the decision was erroneous as contrary to the uncontradicted evidence in the record.

The order of the Commission, affirmed by the Court below, directed that disallowed items be removed not only from the project accounts, but also from all asset accounts

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* See particularly 61a-65a, 86a-87a, 89a-116a, 131a-182a.

by charge to earned surplus. This surplus appears on the fundamental corporate books of Petitioner, which are kept under the authority of the laws of the Commonwealth of Pennsylvania. The accounting jurisdiction of the Federal Power Commission is defined in Section 301(a) of the Federal Power Act of 1935 (49 Stat. 854, 16 U. S. C. A. § 825). This section expressly permits the maintenance of such accounts and records as are required to be kept by or under authority of the laws of any State.

Furthermore, assuming the propriety of the order directing the removal of these charges from project accounts for purposes of administration, a direction to remove them entirely from Petitioner's asset accounts by charge to surplus would appear to conflict with the right of Petitioner to preserve the charges on its records to support its claims of cost and value in any situation in which they may be relevant, and specifically for final determination of its net investment by agreement with the Commission or decree of the Federal District Court in pursuance of Section 14 of the Federal Water Power Act of 1920 (41 Stat. 1071). While this section was amended by the Federal Power Act of 1935 (49 Stat. 844, 16 U. S. C. A. § 807) giving the Commission the right to determine net investment, Section 28 of the 1920 Act provided that no amendment should affect any license theretofore issued, and Article 24 of the license here involved (Appendix, p. 9a) preserved this right to the Licensee.

Specification of Errors

1. The Circuit Court of Appeals erred in sustaining the order of the Federal Power Commission disallowing as part of the project costs the computed construction and engineering profits of Phoenix Utility Company and Electric Bond and Share Company as determined by the Commission.

2. The Circuit Court of Appeals erred in sustaining the order of the Federal Power Commission requiring disallowed items of project cost to be charged to earned surplus of the Petitioner, Pennsylvania Power & Light Company.

Reasons Relied on for Allowance of Writ

1. Substantial issues and questions of federal law of far reaching importance are involved in this case. These questions appear from the foregoing statement, but may be formally posed as follows:

> Whether an administrative agency, specifically the Federal Power Commission, may erect standards of judgment for the determination of matters entrusted to it in conflict with the standards prescribed by the act of its creation and with recognized principles of then existing law. (See *Securities and Exchange Commission* v. *Chenery Corporation*, 318 U. S. 80, 92, 93 (1943); *U. S.* v. *Bethlehem Steel Corporation*, 315 U. S. 289, 308, 309 (1942).)

> Whether the Federal Power Act of 1935 in reenacting the definition of "net investment" as "actual legitimate original cost," "as defined *and interpreted* in the classification of investment in road and equipment of steam roads" of the Interstate Commerce Commission, did not require the Federal Power Commission to follow the interpretations of the classification adopted by the Interstate Commerce Commission between the date of the passage of the original and the passage of the amendatory act. (Emphasis supplied.)

U. S. v. *Dakota-Montana Oil Co.*, 288 U. S. 459, 466 (1933);

Johnson v. *Manhattan Ry. Co.*, 289 U. S. 479, 500 (1933);
Koshland v. *Helvering*, 298 U. S. 441, 445 (1936).

2. It is believed that the decision of the Court below is in conflict with the uniform tenor and holdings of applicable decisions of this Court.

Reduced to its simplest terms the Court below has held baldly that any profit, no matter how reasonable, in relation either to costs to the contractor or competitive charges in similar work between unaffiliated companies is "illegitimate," *i. e.*, unlawful, where a controlling affiliation is established. While the particular decision is limited to project costs under the Federal Water Power Act, the only basis for rejection of the charges disallowed is that they are "illegitimate." How far reaching such a principle, if established, would be it is impossible to predict.

We submit that such a ruling is in conflict with the decisions of this Court hereinbefore cited (see p. 9, *supra*). The only cases cited by the Court below in support of the ruling, viz., *Alabama Power Company* v. *McNinch*, 94 F. (2d) 601 (App. D. C. 1937) and *Alabama Power Company* v. *Federal Power Commission*, 134 F. (2d) 602 (C. C. A. 5, 1943), are clearly distinguished in fact from the case here involved, and the *McNinch* case at least clearly recognizes the allowance of reasonable profit under the factual circumstances disclosed by the record here. (See 94 F. (2d), at pp. 617, 618.)

3. The precedent established by this Court in this case should be determinative of a great number of controversies presently pending before the Federal Power Commission and which may otherwise require judicial decision.

There are in the Electric Bond and Share system some 30 major hydro-electric projects, of which, in addition to the Wallenpaupack project in the Third Judicial Circuit, one is in the Fourth Circuit, four are in the Eighth Circuit, fourteen in the Ninth Circuit and ten in the Tenth Circuit. The same or substantially similar questions to those involved in this particular case are involved in most of these projects, and the decision here should be determinative in all Circuits.*

Affiliated engineering and construction organizations have been employed in many if not most other holding company systems. While doubtless substantial factual differences exist which may govern the application of the legal principles, the precedent here established should be of great value in determining similar issues which might be raised in those systems.

4. The decision of the Circuit Court of Appeals sustaining the order of the Federal Power Commission directing that the disallowed items be charged to earned surplus appears to be in conflict with the decision of the Fifth Circuit Court of Appeals in *Alabama Power Company* v. *Federal Power Commission*, 134 F. (2d) 602 (1943).

The Fifth Circuit Court in the case cited held that jurisdiction of the Power Commission extended solely to accounts set up and maintained under its jurisdiction and not as here to accounts maintained under State authority and supervision (134 F. (2d) at p. 611).

5. The order of the Federal Power Commission affirmed by the Court below in directing the removal of dis-

* The present case was selected by the Commission apparently as a test case, the decision in which should be controlling in all other cases in this system. In some cases we are advised that stipulations have been made that final decision of those cases will follow the final decision in this case. In others we understand that no such stipulations have been made.

allowed items from all asset accounts by charge to earned surplus directs the charge-off of "items of continuing value," apparently contrary to the decision of this Court in *American Tel. & Tel. Co.* v. *United States*, 299 U. S. 232 (1936).

The recent decision of this Court in *Northwestern Electric Company* v. *Federal Power Commission*, 64 S. Ct. 451 (1944), does not dispose of but appears to reserve the questions here presented. The items of cost ordered written off here were costs to Petitioner for services actually received by Petitioner of a value at least equal to the cost thereof. These items do not involve cost to a holding company stockholder for securities later purchased. The order here would appear to raise *inter alia* the question of conflict of jurisdiction suggested at the close of the opinion in the *Northwestern* case.

Conclusion

Wherefore, Petitioner respectfully prays that a writ of certiorari be issued to the United States Circuit Court of Appeals for the Third Circuit in accordance with the practice of this Court, and that a hearing upon and determination by this Court of the matters presented be had.

Dated, March 8, 1944.

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